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TRUSTS & ESTATES[®]

ESTATE PLANNING & ADMINISTRATION

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Looking At A World Of Possibilities For Investing

Gifts To Children: Whose Money Is It Anyway?

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As planners look beyond domestic options, investment planning, with a new global perspective, opens many new doors for investors. Cover courtesy Jos. Palmieri, Augusta, NJ.

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Commentary

Shrinking World Leads To Growing Possibilities

The world has been shrinking for some time in the trust business, particularly in the area of investment. Traditionally, the globalization of assets was the realm of only the bigger players in the field. However, now some of the smaller players are beginning to turn their sights on the rest of the world as they recognize the great opportunities that global investing present. Trust departments across the country are now viewing international investment as a way to control volatility while contributing to a superior return or a portfolio while reducing risk, and they will no doubt draw on the expertise that the big banks have acquired in the past years.

This month, Harry C. Rowney, Senior Vice President of the United States Trust Company of New York, details U.S. Trust's response to what it sees as increased investment opportunities in many areas of the world resulting from better economies, capitalism and trade barrier reductions. He discusses the three new international funds for trust accounts which U.S. Trust has established to help clients diversify their assets in several dozen countries.

And, while new markets open up in the world, the success of a new investment strategy here at home is the subject of an article by James D. Miller, Managing Director and Chief Investment Officer of the Private Investment Group at Continental Bank of Chicago and Daniel J. Cardell, Vice President and Manager of Quantitative Analysis for the Private Investment Group at Continental Bank. The authors discuss the implementation of a new investment style at the bank, from fundamental to quantitative.

Another area of involvement — the limited partnership — has been undergoing some changes, and the normally passive investment now may require active management as trustees and executors administering portfolios including these interests realize that few are yielding their originally projected levels of benefits. Mark S. Thompson, Executive Vice President, and Eggert Dagbjartsson, Senior Vice President of Equity Resources Group, Inc. of Cambridge, MA, discuss recent developments affecting limited partnerships, with particular attention to trends of importance to executors and trustees.

Also this month, Joseph N. DuCanto, partner in the law firm of Schiller, DuCanto & Fleck of Chicago, discusses the intergenerational transfer of wealth and what constitutes "marital property."

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INVESTMENTS

One World Or Three?

International funds at U.S. Trust help clients diversify assets in several dozen countries and take advantage of new opportunities

By **HARRY C. ROWNEY**
United States Trust Company
New York, NY

In response to what it sees as increased investment opportunities in many areas of the world resulting from better economies, capitalism and trade barrier reductions, U.S. Trust has created three new international funds for trust accounts to help clients diversify their assets in several dozen nations. These nations, located in Latin and South America, Europe and the Far East, are growing fast, and we believe investing internationally now presents a great opportunity because it helps control volatility and can contribute to a superior return on a portfolio while reducing risk.

Looking Back, Looking Forward

For more than 40 years, much of the world's political and economic activities were shaped by the Cold War, where the chief protagonists were the U.S. and the U.S.S.R. Within the same period, the U.S. led the promotion of trade expansion through a reduction of barriers among U.N. participants of the General Agreement on Tariffs and Trade. There has been a clear correlation between trade barrier reduction and trade expansion, which has proven particularly helpful to the so-called emerging nations.

The Cold War has ended because the U.S.S.R. bankrupted itself from too many guns and not enough butter for its

population. The U.S. has not quite bankrupted itself, but nations protected by our defense umbrella, including Japan and West Germany, have become economically stronger as their expenditures on non-productive military hardware were relatively small. That economic strength gave them competitive advantages vis-a-vis U.S. industries in general, but also proved to be a benefit to U.S. consumers. Notwithstanding the recent events in the Persian Gulf war, where the U.S. shouldered the bulk of the military burden against a country of 17 million people, it seems likely that economic performance rather than military might will be the measure of national strength in the coming decades. (The U.S.S.R. so far is still a mighty military machine, but economically a paper tiger). Economic alliances rather than military alliances seem the likely direction.

The European Common Market, which may one day have a common currency, is already an economic force to reckon with.

For the past 30 years, an economic alliance called the European Common Market has been evolving and in the last five years has caught the attention of people around the world. The European Common Market, which may one day have a common currency, is already an economic force to reckon with. In the meantime, NATO seems hard pressed to justify its existence in light of the collapse of the Warsaw Pact nations and the unification of Germany. The economic void in central and eastern Europe should ultimately benefit western Europe as the needs of the east represent an opportunity for the technology and capital of the west. New trading patterns should emerge in the geographical expanse between Ireland and the U.S.S.R., which will result in the creation of an expanded economic/trading bloc, with the mark being the base currency until a common currency emerges.

New trading patterns are also emerging in the Americas, which started with the 1989 bilateral trade treaty executed between the U.S. and Canada, and is continuing with a proposed bilateral agreement now being discussed between the U.S. and Mexico.

President Bush has also suggested a North America/South America trading bloc and that proposal must be taken seriously. South America has witnessed

a collapse in right wing dictatorships, similar to the collapse of the left-wing governments in Central Europe. A trend toward capitalism, democratization and free market economies is being pushed, but given the history of South America, there is no guarantee of success. If it becomes reality, the Americas trading bloc will be U.S. dollar-dominated.

Asia and the Western Pacific countries have prospered greatly in the last decade, with the prosperity based initially on the ability to export to the United States both high and low technology products. Hong Kong, Taiwan, and Korea have experienced tremendous growth, which follows the economic revival of Japan. Trading patterns are changing and the biggest change likely will result when the aging Chinese Communist government fades into memory and joins the rest of the economic world. It is an area which has seen extraordinary growth. This bloc will be dominated by the Japanese yen.

Summing up, the significant political changes which continue to occur, coupled with what appears to be a trend away from multilateral to regional and bilateral trade agreements lead us to believe that three significant political and economic trading blocs are evolving. We call these the Pan-European, Emerging Americas, and Asia-Pacific blocs. Their pace of development and economic strengths are likely to be markedly different and pose different levels of risk and rewards to interested investors. But all three will provide many investment opportunities.

U.S. Trust's three new accounts supplement our existing International Stock Fund for Trusts, which invests primarily in the larger industrial markets but does commit a small percentage to emerging nations. A description of the three new common trust funds, and the International Stock Fund for Trusts, all of which are managed through a joint venture with a U.K.-based investor.

The investment objectives of the various international funds are to seek long-term capital appreciation, primarily through the investment in equity securities located and operating outside of the U.S. The receipt of current income is incidental to our investment objectives, but the funds expect to receive current income from dividends or interest from the securities in which they invest.

The funds intend, under normal circumstances, to spread their assets over a broad spectrum of industries and, as a fundamental policy, will not invest

more than 5 percent in any one issuer. U.S. government bonds may be used as an investment for cash reserve purposes but would not be limited to the 5 percent ceiling.

The Risks

Because most of the funds' assets will be invested in the securities of companies located outside the United States, and since revenues will be received primarily in currencies other than the U.S. dollar, the U.S. dollar equivalent of the funds' net assets and distributions will vary downward or upward with fluctuations in the value of such currencies relative to the U.S. dollar.

The funds' investments are subject to adverse affect by local political, economic or diplomatic developments relating to the countries in which they invest. Investments in the securities of companies located in various parts of the world involve certain considerations which are not usually associated with investing in securities of issuers in more developed capital markets such as the U.S. These would include political and economical considerations, such as greater risks of expropriation, nationalization and social, political and economic instability; the small current size of the market for such securities and the relatively low volume of trading, resulting in lack of liquidity and in price volatility; and national policies which may restrict the funds' investment opportunities, including restrictions on the ability of non-resident investors to invest in primary offerings of equity securities and the privatization of state-owned enterprises as well as limitations the percentage of foreign ownership generally or in industries deemed sensitive to relevant national interest. The degree of such risk varies in each country where the funds may invest and is especially high in countries which have not had securities markets or democratic governments in recent times.

Governmental regulation of the securities markets in many countries differ importantly from that of the United States. Accounting, auditing and financial reporting standards in these countries may not be equivalent to standards in the United States, which may result in less information being available to investors of the securities of issuers in these countries than to investors in securities in the United States.

The Funds

International Stock Fund for Trusts.
The International Stock Fund for Trusts

is an international stock portfolio which has the capability to invest broadly outside of the U.S., but which historically has concentrated in the major international markets and, in turn, emphasized the larger capitalization issues. It has placed small amounts of money in countries such as Brazil, Korea and Thailand in the form of closed-end country funds, which will continue. Presently, the countries represented in the fund include Japan, Australia, Hong Kong, Korea, Singapore, Malaysia, Thailand, United Kingdom, France, Germany, Italy, Netherlands, Spain, Norway, Sweden, Switzerland and Brazil. Typical of the names that may be found in the portfolio are Matsushita Electric, China Light & Power, British Gas, Peugeot, Siemens, Banca Commerciale Italiana, Norsk Hydro and Nestle. Managers have the discretion to diversify assets in whatever weightings deemed appropriate but are committed to creating a well-diversified portfolio.

Pan-European Stock Fund for Trusts.
The Pan-European Fund may invest in countries geographic between Ireland and the U.S.S.R., including Turkey.

Western Europe has had a higher real GDP growth rate than the United States, in recent years, and we expect the disparity of growth between the U.S. and Europe will grow larger during the 1990s. As a result, we believe there will be a sound environment for investment in Europe.

Three distinguishing features provide Europe with solid homegrown growth: population density, higher wages, and growing consumer demand. While the geography of Europe is under two million square miles, the population is nearly 500 million. The United States has twice the space and half the people. Real wages are increasing in Western Europe at a faster pace than in other parts of the world, particularly in Northern European countries. The combination of a large population and rising personal incomes in Western Europe has created increasing consumer demand, which has allowed many businesses to flourish. Multinational U.S. companies are wise to this reality and have aggressively expanded their operations abroad.

The crumbling of Communism around the globe has altered the political dynamics of Europe and is being succeeded by economies with free market tendencies. While Western Europe is a well-educated, capital-rich and modern community, Central and Eastern Europe, throttled by disastrous political

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and economic policies for more than half a century, is labor-rich and capital-poor. This creates a perfect marriage between capital and labor, East and West, ultimately requiring the raising of capital for new enterprises and the development of stock markets to facilitate this need.

The single market economy aimed for by 1993 within the European Economic Community will swiftly bring all these political and economic developments into play. A European passport, one currency, unified electrical plug outlets, and distribution centers unencumbered by country borders represent a few of the many changes yet to come. We expect the disappearance of political and economic barriers in Europe to give birth to an efficiently-run Pan-European trading bloc and that this bloc will be a mighty force. Ultimately, we anticipate that one principal European stock market will emerge. By investing in a solely Pan-European fund, we hope to capitalize on some of these growth prospects.

Emerging Americas Stock Fund for Trusts. The Emerging Americas Fund may invest in all countries in the west-

ern hemisphere except the United States. The 1980s have been called the "lost decade" in Latin America, because following the debt crisis in 1982, the region entered a period of low growth characterized by three fundamental problems - political uncertainty, inflation and external debt - each of which hampered economic development. We believe that the rate and the extent of the political, economic and social changes which are taking place in Latin America are, for the region, of comparable significance to the current developments in Eastern Europe and provide exceptional investment opportunities for long-term equity investors.

Within the last two years, governments have come to power in democratic elections, leading to free markets, privatization (except for Chile) and open economy programs in Argentina, Brazil, Chile, Mexico, and Venezuela. In Chile, a privatization program was conducted by the previous administration. These countries are the five principal economies in the region and those in which the U.S. Trust Emerging Americas Fund may initially invest. The new governments are working toward

deregulation of their economies and the reduction of trade barriers.

These significant political changes have spurred progress toward tackling the problem of inflation in the five economies. Inflation is relatively stable in Chile and has fallen dramatically in Mexico and Venezuela. Brazil is in a transitional period following the recent implementation of a new economic program. Argentina has yet to show signs of real progress, but indications of renewed government determination are emerging.

External debt has been a major problem since Mexico began negotiations to reschedule its debt in 1982. Latin American countries have since been unable to arrange significant new financing from the commercial banks. However, the relative strengthening of the international commercial banking community during the 1980s and the subsequent increase in developing country loan loss provisions have enabled many of the region's creditors to find new ways to alleviate their debtors' burden.

Innovative steps which have been taken include the Brady plan, an initiative put forward in 1989 by the U.S. Secretary of Treasury, Nicholas Brady. This focuses on debt reduction, with international commercial banks accepting a negotiated discount on their outstanding debt as the principle means of reestablishing long-term economic stability. Additionally, government-sponsored programs in the five principal economies have facilitated the conversion of debt into equity investments. The debt conversion regulations are currently being redefined in Brazil and Mexico. The absolute levels of outstanding debt have consequently been reduced, as have amounts of debt relative to the GNP in Brazil, Chile and Mexico. In Argentina and Venezuela, levels of debt have not decreased in recent years (although debt relative to GNP is showing a downward trend in Argentina), but the use of debt conversion and the possibility of debt reduction under the Brady plan in the future in both countries is expected to result in measurable progress.

Existing Framework

In addition to these trends toward greater economic strength and political stability, we believe that the five principal economies share certain characteristics which should allow them to take advantage of an improving environment.

In Latin America, there is an established business culture and commercial

EXHIBIT 1

1989 Statistics on Three Global Spheres Pan-Europe, Emerging Americas, Asia/Pacific

	+Total Market Capitalization (U.S.\$ Bn.)	Gross Domestic Product (U.S.\$ Bn.)	Market Cap. As % of G.D.P.	Population (# Millions)
*Pan-Europe	\$2,726.6	\$5,432.4	50.2%	486
** Emerging Americas	\$373.2	\$1,257.1	29.7%	300
***Asia/Pacific	\$518.0	\$1,388.2	37.3%	1,512
Japan	\$2,476.0	\$2,833.7	87.4%	123
United States	\$3,054.0	\$5,163.2	59.2%	249

+ Where Applicable

* Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, The Netherlands, Norway, Poland, Portugal, Romania, Spain, Sweden, Switzerland, Turkey, United Kingdom, Yugoslavia.

** Argentina, Brazil, Canada, Chile, Mexico, Venezuela.

*** Hong Kong, Singapore, Malaysia, Thailand, Korea, Taiwan, Philippines, Indonesia, Australia, China.

Sources: Guide to World Equity Markets-Euramoney Publications, IFC-1990 Emerging Markets Factbook, International Financial Statistics (November 1990)-IMF, Montreal and Toronto Stock Exchange Research Departments, Pacific Rim Stock Markets-October 1990-Baring Securities.

framework, with Argentina, Brazil, Chile, Mexico and Venezuela operating stock markets since the last century. These countries all have a regulatory structure modeled after the Securities and Exchange Commission in the U.S. Efficient settlement procedures are also a feature of these markets.

Private sector businesses have tended to be well-run, as entrepreneurial skills have been strengthened by the need to survive in excessively regulated high-inflation economies. According to World Bank estimates, the private sector accounts for between 4 percent and 14 percent of the total foreign debt in these countries.

Since World War II, the governments of these countries have worked toward diversifying their economies through investment in industry and new technology to avoid over-dependence on primary produce exports, although progress in Argentina has been less significant. Manufactured goods now account for about 60 percent of the exports of Brazil and of Mexico and, in both cases, agriculture represents less than 25 percent of the GNP. It is our belief that the 1990s will see the re-

sumption of the inherent growth in the economies of these countries. The region will continue to benefit from a wealth of natural resources, which include forestry products, minerals and oil, which provide a source of competitive advantage for its established industrial base.

Debtor countries in the Latin American region are now seeking new methods of financing their growth, and private sector companies will increasingly require equity funding from domestic and international markets. Private sector companies will need to demonstrate international competitiveness as they seek to tap external sources of equity finance. The first move by governments to facilitate this has been the reduction of trade barriers. Domestic stock markets will play a growing part in the economy in favor of the private sector. Foreign investment will also play an important part in the development of these economies and is being encouraged by the relaxation of relevant legislation.

Canada. The Emerging Americas Fund will also invest in Canada. Though Canada is an industrialized nation with a greater gross domestic prod-

uct and larger stock market than any country in Latin America, it is a small country in terms of population with 26 million people, which is dwarfed by Mexico's 85 million and Brazil's 147 million people. It clearly has a democratic tradition, but it has gone through periods of considerable political uncertainty, including the threat by Quebec to separate from the rest of the country. The Canada/U.S. trade pact is clearly a long-term positive to this country, which is the most important trading partner of the United States. The emergence of a western hemisphere trading bloc dictates that we should include the potential of Canadian investments as part of our Emerging Americas portfolio.

The Asia/Pacific Stock Fund for Trust. The Asia/Pacific Fund may invest in the Pacific Rim countries and the Indian subcontinent. The spectacular growth in the Asian Pacific region has been one of the most important economic success stories of the last decade. The rise in intra-regional trade has been a remarkable phenomenon and trade flows between the Newly Industrializing Countries (NIC's), which include Hong

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Kong, Singapore, South Korea and Taiwan, and member countries of the Association of South East Asian Nations (ASEAN), which include Indonesia, Malaysia, Thailand, the Philippines, Singapore, Australia, New Zealand and Brunei, have tripled in the last five years, while those between Japan and the NIC's have almost doubled over the same period. Inhabited by over 1.6 billion people, this region is the most heavily populated in the world.

Fueling this growth is a surge of foreign investment, particularly by Japanese manufacturers in search of Asian raw materials and cheap labor. Japan is expected to invest between \$8 and \$10 billion in Asia in 1991, up from \$2 billion in 1985 and almost double the commitment of the United States. Japanese investment is currently more focused on the ASEAN countries, where wages are lower and there is an abundant pool of labor. Japan is a crucial presence in the region as a market for imports and a source of capital and technology.

While Asian Pacific markets suffered major declines in the wake of the Gulf crisis, above average growth prospects and a lessening dependency on oil

should enable these economies to weather rising oil prices better than the United States and Europe. The impact of potentially higher energy costs will vary in the region, with oil-rich Indonesia and Malaysia benefitting while oil-dependent Japan, Korea, Singapore, Taiwan and the Philippines show less resilience. A world economic slowdown resulting from the Gulf crisis will have a negative impact on export-based economies, though ASEAN exporters should have a substantial cost advantage over NIC manufacturers.

Given the trend toward greater regional integration and increased spending on infrastructure, trade-based expansion in the Asian Pacific region seems assured for the foreseeable future. Structural strengths such as high rates of capital formation and savings should sustain above average rates of growth overall. With the advantages of proximity, exporters in the area are poised to reap the rewards of a potential breach in the "wall" of China. Boasting stronger growth rates than the United States or Europe, this dynamic region should present attractive stock market investment opportunities over the longer term.

As we've said, every investment presents some risk, but U.S. Trust is confident that investing in the opportunities these three funds present carries minimal danger. With most of these nations just beginning to exhibit solid economic development now, the potential for investors to reap the benefits is tremendous. □

Harry C. Rowney is a Senior Portfolio Manager and heads the International Investment Department at U.S. Trust Company of New York. Previously, he had been associated with Drexel, Burnham, Lambert Global Management Corporation. He is a member of the Investment Policy Committee, chairman of the International Investment Policy Committee and member of the Investment Strategy Committee. Rowney also manages the UST Master International Fund.

He received his B.A. degree from Trinity College (Connecticut) and attended Columbia Graduate School of Business.

He is a member of the New York Society of Security Analysts and the Financial Analysts Federation.

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